



Phillips, Hager & North Ltd.

Investment Counsellors

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PHILLIPS, HAGER & NORTH FUND

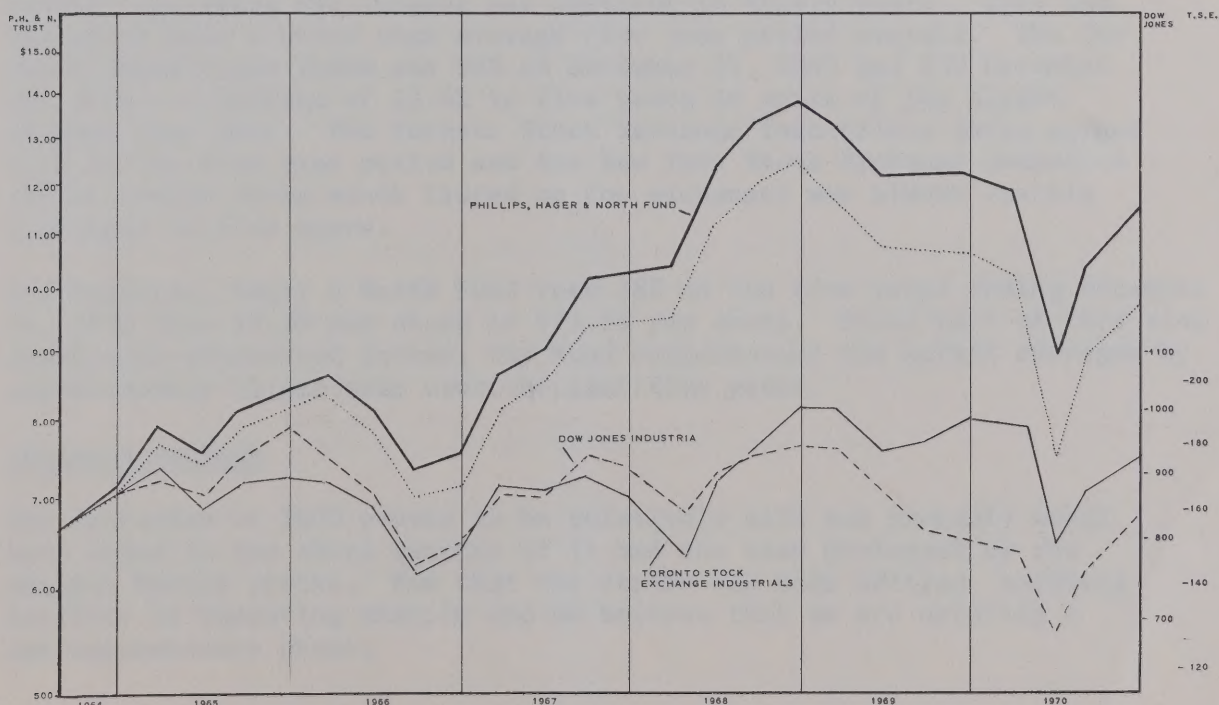
ANNUAL REPORT - 1970

To our Shareholders

Six months ago, it would have been hard to believe that we could finish the year in such a positive frame of mind but the stock market recovery in the last six months has been spectacular. 1970 will probably be remembered as "The Year of the Big V". (see chart below)

The rapid advance that was experienced by the Fund in the third quarter of 1970 continued through the fourth quarter. In the second half of the year the net asset value per share of the Fund rose 31% recovering almost all the decline of the first half. For 1970 as a whole, the net asset value declined 5.5% to \$11.56 from \$12.24 per share. Total assets rose 32% to \$14,400,000.

The chart below illustrates the performance of the Fund since its inception compared with the Dow Jones and Toronto Stock Exchange Industrial Indexes. Since the Fund reinvests all income, the chart includes a dotted line which represents the net asset value per share of the Fund after subtracting 3% per year as if this amount had been paid out in dividends.



Performance in 1970

1970 was a year of great turbulence and wide variations in performance overall. The 5.5% decline experienced by the Fund compared with a decline of 13.6% for the average for the ten largest mutual funds in Canada. Many of you will recall that we used to compare our performance with the ten largest funds in Canada for the purpose of calculating a performance fee. It is interesting to note the range of performance among the ten largest funds. The best performance was a gain of 2.7% and the worst was a decline of 26.0% after reinvesting dividends.

During the year, the Toronto Stock Exchange Index declined 6.4% but the Dow Jones Industrial Index actually closed the year up 4.8%. The Dow represents an average of 30 large blue chip companies which, generally speaking, suffered less in the decline and experienced an earlier recovery. The American Stock Exchange Index, which is made up of smaller companies, experienced a bigger decline in the first half of the year and a more rapid recovery in the latter part of the year but closed down 13.4% for the whole of 1970.

Complicating things for Canadian investors was the freeing of the Canadian dollar. Our dollar rose from 92.5 cents to 99 cents in terms of the U.S. dollar during the year. This meant that the Canadian dollar value of our U.S. stocks was reduced by about 7%. If the Canadian dollar had not been freed, the net asset value per share of our Fund would have been approximately unchanged for the year.

Five Year Performance

We have always felt that investment performance comparisons over short periods of time are relatively meaningless and in fact can be very misleading. Five years is a representative period.

In the five years ending December 31, 1970, we have experienced two bear markets including the longest and nastiest in thirty years. This has therefore been a worse than average five year period overall. The Dow Jones Industrials Index was 968 on December 31, 1965 and 839 December 31, 1970 - a decline of 13.4% in five years in spite of the slight advance last year. The Toronto Stock Exchange Industrials Index gained 3.5% in the five year period and the New York Stock Exchange Composite (which covers every stock listed on the exchange) was almost exactly unchanged in five years.

The Phillips, Hager & North Fund rose 38% in the five years ending December 31, 1970 from \$8.38 per share to \$11.56 per share. Since part of this rise represents reinvested income, the Fund outperformed the market averages by approximately 5% per year over the last five years.

Economic Outlook

The recession of 1970 proved to be relatively mild and probably would have ended in the third quarter if it had not been prolonged by the General Motors strike. Now that the strike has been settled, business activity is improving sharply and we believe that we are entering a new expansionary phase.

The business recession was caused by tight money which was introduced to bring inflation under control. It took some time to do because the inflationary effects of the war in Vietnam and the excessive money supply expansion from 1965 to 1968 could not be corrected overnight. Continued inflation breeds expectation of further inflation and these attitudes prolong the problem.

Governments in both Canada and the United States are now turning their attention to the problem of employment. Monetary policy has been easier since March and fiscal policies are being eased as well. Short term interest rates have declined sharply since the beginning of 1970 and long term interest rates have been declining noticeably for the last six months.

The first effect of easier money is always on the housing industry and this has been the case again. Housing starts have been rising dramatically through the second half of 1970 and 1971 will probably see new all time records. With a continuing heavy increase in the family formation age brackets, the demand for housing is strong. Now that money is easier, this demand can be met. Housing will provide the strongest initial thrust in the new business expansion.

Consumer spending will soon begin to be a strong positive influence on business. Consumers have been cautious for the last year or so in the wake of higher unemployment and an uncertain business outlook. Consumer incomes have continued to grow, although at a more moderate pace, but the rate of savings has been exceptionally high. As confidence returns, the savings rate will decline to a more normal figure and give added impetus to the upswing in retail spending on goods and services.

Corporate profits declined moderately during the recession as corporations experienced a cost squeeze from higher labour costs and lower utilization of capacity. Industry in general is operating at only about 75% of its potential. This means that business does not need a lot of new plant capacity and capital spending is likely to be sluggish for some time. But as business turns up, the utilization of idle plant capacity will prove very beneficial to corporate earnings. We expect a significant improvement in corporate profits in 1971.

Stock Market Outlook

The stock market took almost everything that could be thrown at it in 1970, and survived. We had inflation, recession, declining corporate profits, the bankruptcy of the Penn Central Railroad, bankruptcies and major difficulties in the investment industry, the invasion of Cambodia, a strike at General Motors and this is only a partial list.

But easier money eventually triumphs over all bad news.

The outlook now is for continuing ease in money and a sharp improvement in corporate profits - the ideal combination for stronger stock markets. We have already experienced six months of market recovery, led initially by more conservative stocks and fanning out later into a broad advance.

Phillips, Hager & North Ltd.

We are concentrating the portfolio of the Funds in stocks that we feel have the greatest potential for gain in the next two years. Many retailing and consumer goods companies were hard hit in the bad markets and should benefit tremendously from the anticipated surge in consumer spending in the next two years. Cyclical growth stocks, which show greater than average growth in periods of business expansion, experienced worse than average set backs in the market decline. Their earnings were unfavourable and the pessimistic market attitude exaggerated their difficulties. As a result, many exceptional values are available in industries such as airlines, trucking and apparel manufacturing which should respond well to a resumption of growth in the economy.

We believe that we are in the early stages of a new bull market. The last six months have been excellent and the outlook through 1971 seems very favourable.

Yours very truly,

PHILLIPS, HAGER & NORTH LTD.

A handwritten signature in cursive script that reads "A. Phillips".

Arthur Phillips - President.

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PHILLIPS, HAGER & NORTH FUND

SUMMARY OF ASSETS AS AT DECEMBER 31, 1970

<u>No. of Shares or Par Value</u>	<u>Security</u>	<u>Value</u>
55,000	Rank Organisation	\$ 948,750
17,000	Blue Bell	911,630
35,000	U. S. Industries	681,100
29,700	J. W. Mays	675,675
36,000	Crown Cork & Seal	659,520
11,000	Tropicana Products	645,150
19,000	Lerners Stores	621,870
16,000	International Utilities	584,000
15,000	Fedders Corporation	580,200
18,000	Supermarkets General	550,620
16,000	Delta Airlines	544,000
3,600	McIntyre Porcupine	514,800
31,000	Empire Financial	469,960
9,000	Philip Morris, Inc.	450,450
9,000	McLean Trucking	445,950
20,000	Bank of Nova Scotia	440,000
18,000	Northwest Airlines	386,640
14,000	Uarco	382,200
12,000	Rheingold Corp.	318,480
19,000	Phillips Industries	314,450
18,500	Weldwood of Canada	298,687
10,000	Kings Department Store	265,400
6,000	Aileen, Inc.	248,760
\$200,000	Daylin Bonds	234,600
6,500	Champion Home Builders	229,190
4,000	Ford U.S.	227,520
5,000	Volume Shoes	178,200
5,000	Hyatt Corp.	147,850
4,000	Circle K	141,500
5,000	Texaco, Inc.	138,750
35,000	Block Bros.	138,250
1,200	North Western Steel & Wire	80,688
2,000	Russ Togs	<u>44,740</u>
	Total Portfolio	\$ 13,494,040
	Cash & Receivables	<u>947,413</u>
	Total Assets	\$ 14,441,453
	Net Asset Value Per Share	\$11.56
	Shares Outstanding	1,249,869

